IN THE

Supreme Court of the United States

October Term 1955

No. 170

GENERAL STORES CORPORATION,
Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE AND WAGE CLAIMANTS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT, MAX SHLENSKY

A. ALAN REICH,
Counsel for Respondent, Max Shlensky,
REICH, PELLER, GUADAGNO & CAINE,
221 West 57th Street,
New York 19, New York.

MICHAEL GESAS,
100 West Monroe Street,
Chicago, Illinois.

HOWARD SHUGERMAN,
Of Counsel.

LODER APPEAL PRESS, INC., 65 Duane Street, N. Y. C. WOrth-2-0689

INDEX

	PAGE
Questions presented	1
Statement	2
SUMMARY OF ARGUMENT:	
POINT I.—The Court below properly held that the arrangement procedure of Chapter XI of the Bankruptcy Act is not available to the petitioning corporate debtor with assets and liabilities totalling in the millions of dollars and whose stock is actively traded on a national securities exchange and is held by some 7,000 stockholders. The petitioner is required to proceed under Chapter X of the Bankruptcy Act	5
The 1952 Amendatory Acts amending Section 366 and adding Section 328, wrote into the Bankruptcy Act the law of the U. S. Realty case	8
The petitioner cannot obtain adequate relief under Chapter XI	14
Dismissal of the Chapter XI petition in this case was a proper exercise of discretion on the part of the Courts below	24
Conclusion	26
Appendix	27

CASES CITED

	PAGE
Case v. Los Angeles Lumber Products Co., 308 U. S. 106 (1940)	8
General Stores Corporation, Debtor, 129 F. Supp. 801	24
General Stores Corporation v. Max Shlensky and Securities and Exchange Commission, 22 F. 2d 234	8
In re Journal-News Corp., 193 F. 2d 492	14
In re Transvision, Inc., 217 F. 2d 243	8, 21, 22, 23
Mecca Temple v. Darrock, 142 F. 2d 869 (1944)	7, 9, 21, 22, 23
Northern Pac. Ry. v. Boyd, 228 U. S. 482 (1913)	8
SEC v. U. S. Realty & Improvement Co., 310 U. S. 434	4, 5, 6, 7, 8, 9, 10, 11, 13, 15, 18, 19, 20, 22, 24, 25

STATUTES CITED

BANKRUPTCY ACT	
Section 146	23
Section 147	11
Section 156	18
Section 157	18
Section 158	18
Section 163	18

PAGE

Section 165 18
Section 167 18
Section 169 18
Section 172 19
Section 175 19
Section 176 19
Section 208 19
Section 209 19
Section 212 19
Section 241 19
Section 242 19
Section 243 19
Section 306 14
Section 328 ..... 4, 6, 8, 10, 11, 13, 24
Section 363 13
Section 366 ..... 4, 6, 8, 9, 12, 13

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

No. 170

GENERAL STORES CORPORATION,

Petitioner,

vs.

MAX SHLENSKY, SECURITIES AND EXCHANGE COMMISSION, CREDITORS' COMMITTEE and WAGE CLAIMANTS,

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT, MAX SHLENSKY

Questions Presented

1. Whether the arrangement procedure of Chapter XI of the Bankruptcy Act is available to a corporate debtor with assets of approximately $5,000,000.00 and liabilities of $4,000,000.00, and whose stock is actively traded on the American Stock Exchange and is held by some 7,000 stockholders, or whether such corporate debtor is restricted to the use of Chapter X.

2. Whether there was a proper exercise of discretion on the part of the District Court in this case in determining that a Chapter XI proceeding instituted by such a corpo-

rate debtor was improper and directing that the Chapter XI petition filed by the corporate debtor be dismissed and that it proceed under Chapter X.

Statement of Case

The debtor is a New York corporation and has outstanding approximately 2,232,000 shares, which are in the hands of some 7,000 stockholders (R. 24a). Of the total amount of outstanding shares of the debtor's stock, about 127,000 shares are owned by directors and officers. The stock is in part registered with the Securities and Exchange Commission and is actively traded on the American Stock Exchange (R. 30a). A considerable portion of the stock of the debtor arises directly out of a prior 77b proceeding initiated by the debtor in 1936. Pursuant to the plan of reorganization, which was consummated as of October 31st, 1940, merchandise claims were satisfied by the issuance of stock (R. 30a). The assets of the debtor are listed at about $5,900,000.00 and its liabilities at about $4,000,000.00. During the past five years the debtor has sustained losses totalling about $4,000,000.00 (R. 32a).

Prior to February 15th, 1954, the debtor was known as D. A. Schulte, Inc. and was engaged in operating an extensive chain of retail tobacco stores. As of July 21st, 1954, the debtor was operating 146 Schulte tobacco stores. At the time of the filing of the petition under Chapter XI, the debtor operated some 76 Schulte tobacco stores (R. 42a). Since the date of the filing of the Chapter XI petition and as debtor-in-possession, it has liquidated all the remaining Schulte tobacco stores (R. 54a).

In August, 1953, the debtor purchased all the outstanding capital stock of Stineway Drug Company, a corporation operating a chain of twenty-three retail stores in the Chicago area. These stores operate fountains and lunch

cosmetics, and sell drugs, cosmetics and kindred items (R. 32a). In addition, Stineway also supplies twelve other stores in the Chicago area, which are identified as Stineway System Stores. The purchase price for the Stineway stock was $1,220,320.50, of which $870,000.00 was paid in cash at the time of closing, and the balance was paid on April 15th, 1954 (R. 32a). A sum aggregating $870,000.00 was borrowed by the debtor from Stineway and was applied toward payment of the balance of the purchase price (R. 32a).

Early in 1954, the debtor purchased all the outstanding capital stock of Ford-Hopkins Company at a purchase price of $2,800,000.00 (R. 33a). Ford Hopkins operates a chain of fifty-three drug stores and three restaurants in the City of Chicago and throughout the Mid-West, and also supplies other stores. A down payment of $735,000.00 was made at the time of the purchase of the Ford Hopkins stock (R. 33a). The balance of $2,065,000.00 was to be paid in installments over a period of years. The down payment of $735,000.00 was paid in part from the proceeds of a $400,000.00 loan from Stineway (R. 33a). To secure payment of the balance all of the stock of Ford Hopkins and Stineway has been transferred to a trustee (R. 33a).

The debtor has thus converted from the direct operation of a chain of tobacco stores to the indirect operation through its subsidiaries of a chain of drug stores and supply houses.

On October 18th, 1954, the debtor filed a petition in the District Court for the Southern District of New York under Section 322 of Chapter XI of the Bankruptcy Act, proposing a plan of arrangement whereby unsecured creditors would receive 100% of their claims, payable in annual installments of 20%.

On November 9th, 1954, Max Shlensky, a stockholder of the debtor, moved by order to show cause, pursuant to

Section 328 for an order dismissing the debtor's Chapter XI petition unless it was amended to comply with the requirements of Chapter X. The Securities and Exchange Commission moved to intervene in the proceedings for the same relief. The District Judge granted the motions of Max Shlensky and the Securities and Exchange Commission. The order entered was affirmed by the Court below.

Summary of Argument

The decision of the Court below is in accord with *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.* (cited in argument). In that case it was held that the court, in the exercise of sound discretion, had the power to determine the propriety of a Chapter XI proceeding commenced by a corporate debtor, and that such determination would rest upon the size of the corporate debtor and the public holding of its stock.

In 1952 Chapter XI was amended by the addition of Section 328. This statute "codified the law" of the *U. S. Realty* case. It expressly confers upon the Court the power to determine the propriety of a Chapter XI proceeding, at the inception of the proceeding, on the basis of the size and public holding of the stock of a corporate debtor. Deletion of the "fair and equitable" requirement from Section 366 did not limit in any way the basic holding of the *U. S. Realty* case. Chapter XI is designed and intended to afford relief to small corporations in which there is a substantial identity of stock holding with management. Under the circumstances, the "fair and equitable" rule, with the meaning assigned to it in reorganization proceedings, was never intended to apply to Chapter XI proceedings.

The adequacy of relief obtainable by the petitioner under Chapter XI cannot be appraised solely in terms of the

plan of arrangement proposed. It must be appraised in comparison with that to be had under Chapter X. The "summary procedure" of Chapter XI does not afford adequate protection to the public stockholders of the petitioner. Such safeguards can only be found in a Chapter X proceeding. In the case of the petitioner, the major portion of the outstanding stock is held by public stockholders not identified with management interests. The substantial losses sustained by the petitioner and the transactions entered into by petitioner's management to convert the very nature of the business done by the petitioner compels a study and investigation by a disinterested trustee.

The District Court gave proper weight to the criteria fixed in the *U. S. Realty* case in arriving at its determination that petitioner was required to proceed under Chapter X of the Bankruptcy Act.

POINT I

The Court below properly held that the arrangement procedure of Chapter XI of the Bankruptcy Act is not available to the petitioning corporate debtor with assets and liabilities totalling in the millions of dollars and whose stock is actively traded on a National Securities Exchange and is held by some 7,000 stockholders. The petitioner is required to proceed under Chapter X of the Bankruptcy Act.

This case is, in every essential respect, identical with *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, decided by this Court. They differ only in this regard: in 1952, as a direct result of this Court's *U. S. Realty* decision, Chapter XI of the

Bankruptcy Act was amended.[1] The amendments will be discussed in detail. It is our position that the amendments gave statutory approval to the *U. S. Realty* decision; that the *U. S. Realty* decision continues to be the law governing this case; and that the decision of the Court below constitutes a correct application of that law.

In the *U. S. Realty* case the debtor sought to modify its unsecured obligations on a guarantee of bonds which had been issued by a wholly owned subsidiary. The bonds were then in the hands of some 900 holders. The debtor was a corporation of considerable size with a complicated debt structure and some 7,000 stockholders. The Securities and Exchange Commission moved in the District Court for an order dismissing the Chapter XI petition on the ground that the debtor was required to proceed under Chapter X. In the lower courts the petition of the Securities and Exchange Commission was denied on the ground that the debtor, by filing a petition under Chapter XI proposing a plan of arrangement affecting its unsecured obligations only, had the unqualified right to proceed under that Chapter and the Bankruptcy Court, having obtained jurisdiction, was bound to continue the proceeding.

Reversing the judgment of the lower courts, this Court expressly rejected the interpretation of Chapter XI upon which the lower courts grounded their determination. The right of the debtor to proceed under Chapter XI did not rest solely upon the filing of its petition and the proposal of a plan of arrangement affecting unsecured claims:

> " " " but on considerations growing out of the public policy of the Act found both in its legislative

---

1. Section 366 was amended so as to delete therefrom the requirement that a plan be "fair and equitable". Section 328 was added to the Bankruptcy Act, conferring power on the court to direct a transfer of Chapter XI proceedings to Chapter X.

> history and in an analysis of its terms, and of the authority of the court clothed with equity powers and sitting in bankruptcy to give effect to that policy through its power to withhold relief under Chapter XI when relief is available under Chapter X, which is adequate and more consonant with that policy" (p. 448).

Chapters X and XI were compared and analyzed in detail in the light of their legislative history. Freedom to elect to proceed under Chapter XI was not conferred by the Bankruptcy Act upon all corporate debtors regardless of the circumstances. On the contrary, this Court noted that it was the express policy and intent of the Act that:

> "* * * the two chapters were specifically devised to afford different procedures, the one adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other to composition of debts of small individual business and corporations with few stockholders * * *" (p. 447).

Certain criteria for determining the propriety of a Chapter XI proceeding were fixed by this Court. Chief among these are the distribution of the stock of a corporate debtor among public investors as distinguished from management holdings, the size of the corporation defined in terms of assets and liabilities, and the nature of the debt structure. Measured against such standards, the debtor in the *U. S. Realty* case was patently proceeding under the wrong Chapter, as this Court determined. These same standards were applied in *Mecca Temple* v. *Darrock*, 142 F. 2d 869 (C. A. 2d, 1944), where the Court noted:

> "And since the Supreme Court in the United States Realty case, supra, has made an exhaustive

> comparison and analysis of the respective purposes of, and merits of proceedings under, the two chapters, there is little which can be added to the criteria set forth there" (p. 871).

There again the Chapter XI petition was dismissed. Recently, in the case of *In Re Transvision, Inc.*, 217 F. 2d 243 (C.A. 2, 1955); Cert. den., the Lower Court, by another panel, applying the same principles, found the debtor not to be large enough nor the public holdings of its stock so substantial as to compel a transfer to Chapter X and accordingly, the debtor was determined to have proceeded properly under Chapter XI.

The Court below, in the instant case, in arriving at its determination rested entirely on the *U. S. Realty* and *Mecca Temple* decisions, observing (222 F. 2d 234, at p. 236):

> "The criteria for choice between Chapter XI and Chapter X enunciated in that case (U. S. Realty case) were written into the Bankruptcy Act by the enactment of §328, 11 U. S. C. §728, in 1952. See 1952 U. S. Code Cong. & Adm. News 1979-1980. We are content to apply them here." (Matter within parentheses furnished.)

The 1952 Amendatory Acts Amending Section 366 and Adding Section 328, Wrote Into the Bankruptcy Act the Law of the U. S. Realty Case

At the time the *U. S. Realty* case was considered by this Court, Section 366 required that a plan of arrangement be "fair and equitable". This the Court held required that a Chapter XI plan of arrangement be "fair and equitable" within the meaning fixed in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, and *Northern Pacific Ry. Co.*

v. *Boyd*, 228 U. S. 482. According to the fixed "fair and equitable" rule, unsecured creditors were entitled to a priority over stockholders to the full extent of their claims. A plan of arrangement in which these claims were reduced without some fair compensating advantage to the creditors which was prior to the rights of the stockholders, did not meet statutory requirements. Although this rule had initially been applied in relation to reorganization proceedings, it was held equally applicable to Chapter XI proceedings.

Failure on the part of the debtor in the *U. S. Realty* case to comply with the "fair and equitable" doctrine was but another reason for compelling dismissal of its Chapter XI petition. The clear holding of the *U. S. Realty* case is that this very same conclusion would have been reached had this issue not been raised.

The rule that the right of a corporate debtor to proceed initially under Chapter XI is determined by its size and the public holding of its stock is not incident to or an offshoot from the "fair and equitable" rule. The two rules are from different sources, stand independent of each other, and may be considered interrelated only in the sense that they were both applicable to the same pattern of facts. One is derived from the "public policy of the Act" that there is a line of demarcation between Chapters X and XI and that each Chapter was designed and intended to afford relief to different types of corporations. On the other hand, the "fair and equitable" rule was formulated in reorganization cases and was intended to apply to such cases only. But being "words of art", as this Court noted, with fixed and determined meaning, "fair and equitable", when inserted into Section 366 of Chapter XI, were deemed to carry with them such fixed and determined meaning.

This is forcefully illustrated in the *Mecca Temple* case. The basis of that decision was that the debtor, on the

strength of the criteria set forth in the *U. S. Realty* decision, had no right to proceed under Chapter XI. After discussing the *U. S. Realty* decision, and concluding that the criteria as set forth in that decision compelled dismissal of the debtor's Chapter XI petition, the Court observed (p. 872):

> "Yet another reason for reversing the holding below may be found in Bankruptcy Act, section 366(3), which provides that a plan shall not be confirmed unless 'it is fair and equitable' . . ."

When the *U. S. Realty* case was under consideration by this Court, Chapter XI did not contain any provision which, by express statutory language, limited its procedures to certain types of corporations. Nor did it by express language, confer on the court the power to make such determination and to give effect thereto by dismissing the petition. In the absence of such express statutory language, this Court found such limitation on the use of Chapter XI in the "public policy of the Act" and the power of the Court to withhold relief under Chapter XI in the equity powers of the court, sitting as a court of bankruptcy, to give effect to that policy.

This law of the *U. S. Realty* decision was written into statutory law by the Amendatory Acts of 1952 which added Section 328 to Chapter XI.[2] Section 328 expressly grants to the Judge power to dismiss a petition under Chapter XI "if he finds that the proceedings should have been brought under Chapter X of this Act".[3] The purpose of Congress in enacting Section 328 was stated to be:

---

2. This was the interpretation given by Judge Clark in the Court below to the amendatory Acts.

3. In the *Mecca Temple* case the court held that the referee had the power to make such determination. But by using the word "judge" instead of the word "court", Section 328 has taken that power out of the hands of the referee.

> "in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, * * * where a petition was filed under chapter XI by a debtor corporation having hundreds of creditors and thousands of stockholders, it was decided that the court had the duty to dismiss the petition, leaving the corporate debtor to seek relief under chapter X * * *."

and

> "It (Sec. 328) codifies the law of the United States Realty & Improvement case, and adopts the procedure of section 147 for transferring the proceeding to chapter X." (Senate Report No. 1395 on §2234, 82nd Cong. 2nd Sess. (1952) 11; 1952 U. S. Code Cong. & Adm. News 1979-80.)

But the petitioner erroneously argues that a companion amendment deleting the "fair and equitable" requirement from Section 366 constituted a statutory reversal of the *U. S. Realty* decision. It appears to be the petitioner's position that the criteria fixed by this Court resulted only from application of the "fair and equitable" rule. With the elimination of that rule, Petitioner argues, only the plan of arrangement itself may be considered in determining the propriety of a proceeding under Chapter XI. Thus, Petitioner states, Chapter XI is available to all corporations as long as a plan of arrangement is proposed which meets the requirements of that chapter. If this position is properly taken, then in the absence of the "fair and equitable" rule, this court would have come to a contrary conclusion in the *U. S. Realty* case and would have affirmed the holding of the lower courts where the same position was adopted.

To sustain the position of the Petitioner, we are obligated to overlook the clear language of the *U. S. Realty* opinion, to ignore the Congressional report on Section 328, to render entirely ineffectual and meaningless that statute,

and to consider as mere surplusage the Senate and House reports on the amendment to Section 366. In those reports the following observation on the purpose for so amending Section 366 was made:

> "However, the fair and equitable rule cannot be applied in a chapter XI, XII, or XIII proceeding if construed as interpreted in Northern Pacific Railway Co. v. Body (228 U. S. 482, 33 S. Ct. 554, 57 L. Ed. 931 (1913)), and reaffirmed in Case v. Los Angeles Lumber Products Co., Ltd. (308 U. S. 106, 41 Am. B.R. (N.S.) 110, 60 S. Ct. 1, 84 L. Ed. 110 (1939)), without impairing, if not entirely making valueless, the relief provided by these chapters. If so applied, no individual debtor or corporate debtor (where stock ownership is substantially identical with management) under chapter XI, and no individual debtor under chapter XII or XIII can effectuate an arrangement or plan by scaling of debts.
>
> The fair and equitable rule was never applied in a composition proceeding under the former section 12 of the Bankruptcy Act, which has been replaced by chapter XI, nor is it practicable or realistic to apply it in a proceeding under chapter XI, XII, or XIII." (Senate Report No. 1595 on S. 2234, 82nd Cong., 2nd Sess. (1952) 11; 1952 U. S. Cong. and Adm. News, 1981-2).

Since Chapter XI was designed for small corporate debtors which were substantially management owned, it may be said that the "fair and equitable" rule was never intended to be applied with its full impact to the more simple arrangement plans under Chapter XI. It was in

tended to apply only to reorganization proceedings and plans.[4]

Section 328 may only be considered properly with the *U. S. Realty* decision as a framework of reference. It ratifies and expresses the law of that case that it is within the powers and duty of the court to grant or withhold the relief under Chapter XI depending upon the corporate structure of the debtor and its status as a publicly held corporation. Omission to spell out the *U. S. Realty* criteria is without significance. It was sufficient for Congress to confer by express statutory provision such powers on the court in the light of the *U. S. Realty* decision.

Petitioner would have Section 328 invoked only in those instances where the plan of arrangement is itself incapable of confirmation.[5] At the same time Petitioner urges that the plan may only be tested by the requirements of Section 366.[6] Putting aside the requirements of subsections (1), (3) and (4) of that section as being inapplicable to the discussion, we are left merely with the requirement that a plan be in "the best interests of creditors". Yet this requirement is satisfied by a demonstration that the creditor body stands to gain more from the plan of arrangement than from a liquidation of the debtor.[7] Should a contrary finding be made there is nothing to prevent the debtor from proposing another plan, one meeting the objections to the former plan.[8] In this connection it may be noted that

4 It was observed in the *U. S. Realty* case that with respect to small corporations essentially management owned, preservation of going concern value of the debtor through its continued management by stockholder managers would be adequate compensation for the reduction of unsecured claims without alteration of management interests. Although the "fair and equitable" rule no longer applies, Judge Clark applied its "exception" as a test, apparently on the belief that the "exception" expresses the philosophy of Chapter XI.

5 See 8 Collier on Bankruptcy (14th ed.) 1107 et seq.

6 Section 366.

the plan first proposed in the petition is very often not the one confirmed. In many cases the exigencies of the moment demand immediate filing of a Chapter XI petition to maintain the *status quo*. All efforts are bent in the direction of speed. Insufficient time is devoted to the plan itself. The debtor contents itself in the knowledge that at some later time, after a creditors' committee has been formed, it may negotiate with that committee and formulate a plan acceptable to itself and the committee.

Moreover, a Chapter XI plan of arrangement may affect unsecured claims only.[7] A plan which proposes some alteration of rights incident to stock ownership or some readjustment of secured claims is intrinsically defective and is beyond the jurisdiction of the court to consider and confirm. We may assume that in the Petitioner's scheme of things Section 328 would be limited in its application to such plans. In the light of that statute's legislative history, this places an unduly restrictive and narrow interpretation on the statute. For all practical purposes Section 328, if so interpreted, would be consigned to the role of a useless appendage to the Bankruptcy Act.

The Petitioner Cannot Obtain Adequate Relief Under Chapter XI

We agree that if the Petitioner is permitted to proceed under Chapter XI and a plan of arrangement is confirmed, it will achieve some financial relief derived from a scaling down of unsecured debts. But this is not the point. Because of the presence of some 7,000 stockholders, it does not rest with management alone to determine whether the remedies afforded by Chapter XI are adequate. Adequacy of relief in this case is not tested by the plan alone, that is,

---

7. Section 360(1). *See In Re Imperial Mines Corp.*, 195 F. 2d 492 (1951).

by what management deems may be beneficial to the Petitioner. As this Court noted in the *U. S. Realty* case:

> "Obviously the adequacy of the relief under Chapter XI must be appraised in comparison with that to be had under Chapter X, and in the light of its effect on all the public and private interests concerned including those of the debtor" (p. 455).

Chapter XI grants a "summary procedure" (*U. S. Realty* case, p. 446) particularly adapted to afford financial relief to small corporate debtors, essentially management-owned. It is a proceeding which, subject to the supervision of the Bankruptcy Court, is management-controlled. In the Southern District of New York the practice is to continue the debtor in possession. As a debtor-in-possession, management continues to direct the affairs of the Petitioner. Controls which are exercised by the Court relate generally to the prevention of undue diminution of assets of the estate, to assure that in the event an order of adjudication in bankruptcy is ultimately entered, the estate will have approximately the same value it had at the time the Chapter XI petition was filed.

We have, in the case of the debtor, a striking example of the control which management exercised over the affairs of a debtor-in-possession during the pendency of a Chapter XI proceeding. At the time the Chapter XI proceeding was instituted, the petitioner was operating a chain of retail tobacco stores. Previously it had embarked upon a program of discontinuing the operation of this type of store. But at the time of the filing of the petition, the Petitioner was still operating 76 retail tobacco stores. As a debtor-in-possession, the Petitioner ceased the operation of all of such stores and was able to complete its conversion to a holding company structure, operating through subsidiaries chains of drug stores. In effect, therefore,

the Petitioner was enabled to effect an informal "reorganization". This was done without the scrutiny of the Securities and Exchange Commission, the only agency capable of protecting the interests of the public stockholders. Consequently, the propriety of the action so taken by the Petitioner did not receive the full attention and consideration required.

Management alone formulated the Petitioner's plan of arrangement. In the event that this plan is not acceptable to the creditors' committee, management alone will negotiate with the creditors' committee to formulate a plan acceptable to both management and the committee. No controls whatsoever are exercised by the Court in this phase of the Chapter XI proceeding.

Petitioner also fallaciously argues that the creditors' committee appointed in the Chapter XI proceeding constitutes a form of safeguard, which renders invoking the provisions of Chapter X unnecessary. Creditors' committees generally consist of trade creditors only. This would certainly hold true in the overwhelming number of Chapter XI cases. We can assume that a number of the members of the committee in this case are creditors whose claims arose out of the operation of the tobacco stores. Whether or not these creditors would continue to have any real further interest in the Petitioner is open to question.

In any event, the creditors' committee does not represent a form of control which is an adequate substitute for the machinery of Chapter X. Too many risks are entailed. It would be necessary to assume, if the Petitioner's argument is accepted, that in all instances the composition of the creditors' committee would be such that the committee would be truly vigilant and fully understanding of all the problems confronting the debtor. As creditors holding trade claims, the members of the committee cannot be expected to demonstrate the necessary consideration for the

welfare of a Chapter XI debtor; their interest is limited to assuring payment in accordance with the plan. Moreover, as trade creditors, the interests of the creditors' committee are truly antithetical to those of the public stockholders.

The debtor's argument that the Plan alone must be considered, and that it may only be tested by the requirement that it be in the "best interest of creditors renders complete exclusion of any consideration of the rights of Public stockholders in the proceeding."[8]

In this case where the public holding of the stock of a debtor is so considerable that management holds but a minor portion of the total outstanding issue of the stock, Chapter XI may be used by management to avoid full disclosure of its responsibility for the condition of the corporation and to perpetuate itself in control. Even though the jurisdiction of the Bankruptcy Court has been invoked, it is without power to aid individual stockholders in the Chapter XI proceeding, who may question management's handling of the affairs of the debtor. Such stockholders would be compelled to look to the State Law and institute proceedings in the State Court.

In the case of the debtor, there have been losses totalling $4,000,000.00 during a period of great prosperity. The business in which the petitioner engaged has been abandoned. Through various arrangements which have been made, petitioner has been converted into a holding corporation. Even here, however, the debtor's position is most precari-

8. Petitioner's arguments lead it into strange areas of self-contradiction. It states that as a result of the amendatory acts, only the plan may be considered and whether such plan is in the best interests of creditors. But petitioner also argues that the clear intent of the amendments was to confer on all stockholders of a debtor the right and opportunity to attain a reduction of unsecured debts without an alteration of their interests.

ous. To secure payment of the balance of $2,650,000.00 remaining unpaid on the purchase of the Ford Hopkins stock the petitioner has transferred to a trustee, as collateral, all the stock of Ford Hopkins and Stineway. These interests have thus been placed in grave jeopardy. None of these matters are subject to the examination of the Bankruptcy Court sitting in a Chapter XI proceeding.

We urge that these matters require detailed examination and investigation. Only through Chapter X can this be accomplished. Chapter X alone provides the necessary machinery to protect "the investing public dissociated from control or active participation in management" who "needs the impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems", *U. S. Realty*, p. 448. This Court summarized the safeguards provided by Chapter X as follows (pp. 448-450):

> "The creation of the Securities and Exchange Commission, specially charged by various statutes with the protection of the interests of the investing public, and observed inadequacies of section 77B, led to its revision and enactment in changed form as Chapter X, so as to provide for a larger measure of control by the court over security holders' committees and the formulation of reorganization plans and to secure impartial and expert administrative assistance in corporate reorganizations through participation of the commission. Except where the liabilities are less than $250,000, Chapter X requires the appointment of a disinterested trustee, §§ 156, 158, and a thorough examination and study by the trustee of the debtor's financial problems and management, § 167(3)(5). The trustee is required to report the result of his study, to send the report to all security holders with notice to submit to him proposals for a plan of reorganization, § 167(5)(6).

He then formulates a plan or reports the reasons why a plan cannot be formulated. § 169. By § 170 consent to a plan in advance of its initial approval by the judge is void unless procured with his consent. A large measure of control is given to the court over the reorganization and of committee of security holders and their compensation. §§ 163, 165, 209, 212, 241-243.

If the judge finds the plan presented worthy of consideration he may refer it to the commission for report and must do so where the liabilities of the debtor, as in the present case, exceed $3,000,000. § 172. When the plan is submitted to creditors after approval by the judge it is accompanied by the report of the commission and the opinion of the judge approving the plan. § 175. The commission with the approval of the court is authorized to participate generally in the proceedings as a party, and it is its duty to do so upon request of the court. § 208.

By comparing its plan of arrangement with the one involved in the *U. S. Realty* case, the debtor seeks to distinguish the *U. S. Realty* case from the instant one. We have previously noted that the petitioner also urged that the decision received statutory reversal in the 1952 Amendatory Act. Petitioners as it will be noted later also urges that the decision was contrary to law. In essence it is the position of the debtor that whereas the *U. S. Realty* plan involved modification of claims in the form of bonds held by the investing public, petitioner's plan, on the other hand, directly affects trade claims only and that accordingly, the interest of the public stockholders is not directly involved. In other words, the petitioner wishes this Court to disregard all of the criteria which it fixed for determining the propriety of a Chapter XI pro-

ceeding and look solely to the plan of arrangement. It is essentially a repetition of the very argument rejected in the *U. S. Realty* case.

The *U. S. Realty* decision is grounded on the broad basis of public policy as expressed in the Bankruptcy Act. It fixed definite limitations on the utilization of Chapter XI. Although this Court was concerned in the *U. S. Realty* case with protecting two classes of public investors, bondholders and stockholders, it is clear that the decision was not based upon the attempted alteration of rights of public bondholders. Rather the decision was based upon the fact that the debtor there was a corporation with assets and liabilities in the millions of dollars and had some 7,000 stockholders. It is reasonably clear that the same result would have been reached by this Court had the plan not encompassed the claims of the public bondholders. The opinion of this Court will be read in vain for any indication that a contrary result would have been reached in the absence of such public bondholders. All the protection afforded under Chapter X, as noted by this Court, were required to protect all public investors, regardless of class or type of investment holding.

Actually, however, when the petitioner compares its plan with the one in the *U. S. Realty* case, it urges that the *U. S. Realty* proceedings were dismissed because the plan could not meet the requirements of the "fair and equitable" rule. It is not, therefore, so much interested in distinguishing the *U. S. Realty* case even on the basis of a comparison of the respective plans as it is in showing, however erroneous, that because the "fair and equitable" rule is no longer a part of Chapter XI, the *U. S. Realty* decision is not applicable to this case.

The argument of the petitioner that no need to invoke the safeguards of Chapter X is evidenced in this case, because the stockholders stand to gain from the scaling

down of trade obligations, is specious. The most that can be said for this argument is that the condition of the petitioner is so grave that any action at all which is taken to prevent its destruction must of necessity inure indirectly to the benefit of stockholders. Any such so-called gain is more theoretical than actual. The Chapter XI proceeding, if permitted to continue, might prove to be merely a "breathing spell". The petitioner has a previous record of serious financial difficulty. Its present condition is grave. No reasonable assurance can be given that the debtor will not find itself back in the hands of the Bankruptcy Court in the near future, even if its plan of arrangement should be confirmed. Sacrifice of all the safeguards of Chapter X is too great a price to be paid for such so-called gain.

We do not urge that the mere presence of a public stockholding body is sufficient to compel a transfer of Chapter XI to one under Chapter X. As it was observed by this Court, there is no:

> "* * * definition or classification which would enable us to say that a corporation is small or large, its security holders few or many, or that its securities are 'held by the public', so as to place the corporation exclusively within the jurisdiction of the court under one chapter rather than the other" (p. 447).

In the *Mecca Temple* case the same observation was made:

> "Of course, there is still no well defined answer in the border line cases to the question as to whether a particular type of corporation should be permitted to proceed under Chapter XI; * * *" (p. 871).

Recently, in the *Transvision* case the Court below was confronted with just such a problem. The debtor in that

case had outstanding 385,000 shares of common stock and 1,773½ shares of preferred stock. All of such stock was held by management interests, except 135,000 shares of common stock which were held by but 435 public investors. The corporation was a comparatively small one, having liabilities of about $700,000.00 and assets of about $1,000,000.00. In that case the Court held that the debtor was properly proceeding under Chapter XI. The mere existence of 435 stockholders holding a minor portion of the stock of the debtor was not sufficient to compel a transfer of the proceeding to Chapter X. But, applying the principle of the *U. S. Realty* decision, the Court observed:

> "In this connection, it may be observed that the more complex the debt structure and diffuse the stock distribution, the greater the likelihood that Chapter XI will not afford adequate protections and the greater the impulsion to relegate the petitioner to the relief afforded him under Chapter X. Securities Commission v. U. S. Realty Co., 1940, 310 U. S. 434, 60 S. Ct. 1044, 84 L. Ed. 1293; Mecca Temple, etc. v. Darrock, 2 Cir., 1944, 142 F. 2d 869" (p. 246).

We do not believe that the *Transvision* case is inconsistent either with the holding in the *U. S. Realty* case or with that of the *Mecca Temple* case. The *Transvision* debtor was neither large enough nor was the public holding of its stock so substantial as to bring it within the holding of the *U. S. Realty* or *Mecca Temple* cases. By referring to the feasibility of the *Transvision* plan, the Court did not depart from the criteria as fixed in the *U. S. Realty* case or in the *Mecca Temple* case. Having concluded that initially the *Transvision* debtor was not required to proceed under Chapter X, the Court then properly addressed itself to the plan of arrangement.

Accordingly, the *Transvision* decision does not represent a departure from the rule of the *U. S. Realty* and *Mecca Temple* cases that determination of the propriety of a Chapter XI proceeding should be made at the beginning of the proceeding.

Patently, the petitioner is not that particular type of corporation which, by reason of its size or diffusion of stock holding, constitutes "a border line case", or one in which it is difficult to determine whether it is large or small or directly held by the public. The facts were so compelling that the Judge in the District Court, upon a comparison of the *Transvision* debtor with the petitioner, directed a transfer of the Chapter XI proceeding to one under Chapter X.

Petitioner rests heavily on Section 146, which provides that a Chapter X petition shall not be deemed to be filed in good faith if adequate relief is obtainable under Chapter XI. Petitioner here argues that it could not in good faith state that adequate relief was not obtainable under Chapter XI. This merely begs the question. A ruling by the Court that the petitioner must proceed under Chapter X is a ruling that Chapter XI does not afford adequate relief to the petitioner. Had the petitioner initially filed a petition under Chapter X, the Court, applying the same rules, would have been constrained to approve the petition on the ground that the petition did comply with the requirements of Section 146.

Dismissal of the Chapter XI Petition in This Case Was a a Proper Exercise of Discretion on the Part of the Courts Below

Determination of the propriety of a Chapter XI proceeding rests with the Court in the exercise of sound discretion. That the Court has this discretionary power was stated in the *U. S. Realty* case:

> "In this situation, we think the court was free to determine whether the relief afforded by Chapter XI was adequate as it would have been if respondent had filed its petition under Chapter X" (p. 456).

But in making such determination the Court is required to apply the criteria set forth in the *U. S. Realty* case. In each case the question turns on whether the Court properly evaluated the debtor in the light of these criteria. Being addressed to the debtor itself, to its size, the nature of its debt structure, and the public holding of stock, rather than to the plan proposed, these criteria require that determination be made by the Court at the beginning of the proceeding. Otherwise, as Judge Clark noted, the real value of such determination is lost. The power to make such determination at the inception is expressly conferred on the Court by Section 328.

The facts in this case are so clear that they compelled dismissal of the Chapter XI petition. As we noted previously, a comparison of the petitioner with the *Transition* debtor rendered it impossible to arrive at any other conclusion. The facts which are material to the determination are: the debtor is a corporation with assets and liabilities running into the millions of dollars; it has some 7,000 stockholders who hold the major part of the stock; it has sustained in the years immediately preceding the filing of the petition losses in the millions of dollars, yet

this was a period of prosperity; management has altered completely the very nature of the business done by the debtor; management has placed the very existence of the debtor in peril by pledging its only assets to secure payment for the Ford Hopkins stock.

These facts underscore the need for a thorough study and investigation by a disinterested trustee. The fact that no actual wrong doing on the part of management has at this time been uncovered is immaterial. In the *Transvision* case this point was important only because the debtor otherwise qualified to proceed under Chapter XI.

As Judge Clark noted:

> "Now the new common (stock) is again partially under water and the stockholders are justifiably concerned, for their interests are in no way protected in a chapter XI proceeding * * *" (p. 236),

and

> "They wish some assurance of a fair plan now before the remaining assets are dissipated" (p. 236).

The argument of petitioner that the *U. S. Realty* decision was contrary to law is without merit. Petitioner here urges that despite the Amendatory Acts of 1952, which expressly wrote into statutory law the holding of the *U. S. Realty* case, this Court should now reverse itself. The *U. S. Realty* case properly expressed the law of Chapter XI and retains all its vigor at this time.

CONCLUSION

The judgment of the Court below should be affirmed.

Respectfully submitted,

A. Alan Reich,
Counsel for Respondent, Max Shlensky,
Reich, Peller, Guadagno & Caine,
221 West 57th Street,
New York 19, New York.

Michael Gesas,
100 West Monroe Street,
Chicago, Illinois.

Howard Shugerman,
Of Counsel.

APPENDIX

In addition to the Statutes set forth in the appendix to petitioner's brief, the following Statutes are involved:

Sec. 156. Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

Sec. 157. An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: *Provided, however*, That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

Sec. 158. A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—

(1) he is a creditor or stockholder of the debtor; or

(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Sec. 163. Upon the approval of a petition, where the debtor is continued in possession, the debtor shall, at the expense of the estate, prepare, make oath to, and file in court, within such time as the court shall fix

(1) a schedule of its property, showing the location, quantity, and money value thereof;

(2) a schedule of its creditors of each class, showing the amounts and character of their claims and securities and, so far as known, the name and post office address or place of business of each creditor; and

(3) a schedule of its stockholders of each class showing the number and kind of shares registered in the name of each stockholder, and the last known post-office address or place of business of each stockholder.

Sec. 165. If in any case it appears that a person, other than the debtor or its trustee, has in his possession or under his control a list of security holders of the debtor or information in respect to their names, addresses, or the securities held by any of them, and such list or information is necessary, in order to disclose the names and addresses of the beneficial owners of such securities, or to prepare or complete the schedules required to be filed under section 163 of this Act or the lists required to be filed under section 164 of this Act, the court shall direct such person, after a hearing upon notice to him, to produce such list or a true and correct copy thereof, or to furnish such information, or to permit the inspection or use thereof, as may be deemed by the court necessary for the foregoing purposes.

Sec. 167. The trustee upon his appointment and qualification—

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

(5) shall, at the earliest date practicable, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate; and

(6) shall give notice to the creditors and stockholders that they may submit to him suggestions for the formulation of a plan, or proposals in the form of plans, within a time therein named.

169. Where a trustee has been appointed the judge shall fix a time within which the trustee shall prepare and file a plan, or a report of his reasons why a plan cannot be effected, and shall fix a subsequent time for a hearing on such plan or report and for the consideration of any objections which may be made or of such amendments of plans as may be proposed by the debtor or by any creditor or stockholder.

172. After the hearing, as provided in section 169 or section 170 of this Act, and before the approval of any plan, as provided in section 174 of this Act, the judge may, if the scheduled indebtedness of the debtor does not exceed $3,000,000, and shall, if such indebtedness exceeds $3,000,000, submit to the Securities and Exchange Commission for examination and report the plan or plans which the judge regards as worthy of consideration. Such report shall be advisory only.

175. Upon the approval of a plan by the judge, the trustee or the debtor in possession shall transmit, by mail or otherwise, to all creditors and stockholders who are affected by any such plan—

(1) the plan or plans so approved, together with a summary thereof approved by the judge;

(2) the opinion of the judge, if any, approving the plan, or plans, or a summary thereof approved by the judge;

(3) the report, if any, filed in the proceeding by the Securities and Exchange Commission, as provided in section 172 of this Act, or a summary thereof prepared by the Securities and Exchange Commission; and

(4) such other matters as the judge may deem necessary or desirable for the information of creditors and stockholders.

Sec. 176. No person shall, without the consent of the court, solicit any acceptance, conditional or unconditional, of any plan, or any authority, conditional or unconditional, to accept any plan, whether by proxy, deposit, power of attorney or otherwise, until after the entry of an order approving such plan and the transmittal thereof to the creditors and stockholders, as provided in section 175 of this Act; and any such authority or acceptance given, procured, or received by reason of a solicitation prior to such approval and transmittal shall be invalid, unless such consent of the court has been so obtained.

Sec. 208. The Securities and Exchange Commission shall, if requested by the judge, and may, upon its own motion if approved by the judge, file a notice of its appearance in a proceeding under this chapter. Upon the filing of such a notice, the Commission shall be deemed to be a party in interest, with the right to be heard on all matters arising in such proceeding, and shall be deemed to have intervened in respect of all matters in such proceeding with the same force and effect as if a petition for that purpose had been allowed by the judge; but the Commission may not appeal or file any petition for appeal in any such proceeding.

Sec. 209. Any creditor or stockholder may in a proceeding under this chapter act in person, by an attorney at law, or by a duly authorized agent or committee.

Sec. 212. The judge may examine and disregard any provisions of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor.

Sec. 241. The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act.

Sec. 242. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

Sec. 243. The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. In fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.